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Agenda Item 3f

December 13, 2011

TO: MEMBERS OF THE PERFORMANCE AND COMPENSATION COMMITTEE

- I. **SUBJECT:** Investment Office Classification and Organization Study
- II. **PROGRAM:** Administration
- III. **RECOMMENDATIONS:** This is an information item
- IV. **ANALYSIS:**

Background

One of the six Investment Office Roadmap strategic priorities is to strengthen organization systems and controls. In the fall of 2010, the CalPERS Investment Office (INVO) completed a risk heat map and target operating model project to evaluate the operating environment and identify priorities for improvement. The results were presented to the Investment Committee in February 2011 (Attachment 1). The risk heat map identified the top three risks in the Investment Office as data integrity, portfolio data & analytics and the overall control environment. Several people related issues were also identified as top risks, specifically "Skills and Capabilities" (risk 10 of 23) and "Recruiting and Retention" (risk 14 of 23).

The "Skills and Capabilities" risk was defined as the lack of key business, investment management and/or technical expertise necessary to run the organization and ensure the appropriate division of insourcing vs. outsourcing of skills, functions and expertise. In the February, 2011 Investment Committee presentation, INVO indicated that there are capability gaps in key control and operations functions, including performance attribution, investment technology management, financial management, and risk and compliance. People in these functions, especially at the more journey and senior levels, should have investment and/or financial industry experience to function most effectively.

The existing Investment Office job classification structure was not designed to accommodate hiring investment industry experienced people into investment-related operations or control functions; it was designed primarily to accommodate portfolio management and trading functions. In addition, the job classification structure was designed when the fund was much smaller and the breadth of activities performed was much narrower. The existing job classification structure does not reflect the needs of a \$220 billion+ fund invested in seven major asset classes across multiple defined benefit, defined contribution and health-related

trusts. In addition, staff believes that investment and/or financial industry experience is a requirement for appropriately staffing the new function to be headed by the Chief Financial Officer, as well as enterprise risk management and compliance functions.

Classification and Organization Study

To address the issues with the existing classification structure, INVO and the Human Resource Services Division (HRSD) have launched an Investment Classification and Organization study. They have engaged KPMG Management Consulting to assist in this effort. A joint INVO, HRSD, and KPMG team is currently conducting an assessment of INVO functions including an identification of strengths, weaknesses, issues, and opportunities regarding INVO's current classification and organizational structure.

The methodology employed by the team includes interviewing similar investment management entities in both the private and public sectors to develop an understanding of industry organization structures, staffing levels and job classification frameworks; and to gather industry benchmark information from benchmarking firms in the human resources and financial services industry. The study includes evaluating INVO's current structure and required functions, comparing INVO to similar investment management organizations, identifying common themes in organization structures and job functions, developing a plan to address identified gaps, and preparing documentation to facilitate the desired changes.

The scope of the review/assessment includes INVO's support, control, and internal and external money management functions. The study includes a review of classifications and job families in the State's existing classification plan for possible use in INVO, as well as identification of possible changes needed to best meet INVO's current requirements. We will also be reviewing whether these or similar classifications would be appropriate to staff the CFO and Enterprise Risk/Compliance functions.

Next Steps

It is expected that Phase I of this effort will be completed in January of 2012, and that the results of the classification review and organizational assessment will serve to mitigate some of the high-risk areas identified in the INVO Heat Map and enable delivery of INVO's Target Operating Model (TOM). The study will provide CalPERS and INVO with critical information needed to propose and obtain approvals for changes that will strengthen our staff capabilities as required to meet our investment performance objectives, and manage operational and investment risk.

V. RISKS:

There are no risks associated specifically with this Information Item. There are significant risks to CalPERS if the study is not successful in ultimately revising the job classification structure. Specifically, there is a risk that CalPERS will not be able to recruit or retain people with the full range of skills needed to support the investment process, finance, risk and compliance functions. This will result in continued high levels of operational and compliance risk.

VI. STRATEGIC PLAN:

The INVO Classification and Organization project, along with the Risk Heat Map and TOM projects, are aligned with the INVO Organization Systems and Controls to support the following CalPERS Strategic Goals:

- Goal I – Exercise global leadership to ensure the sustainability of CalPERS pension and health benefit systems.
- Goal III – Sustain a high performance work culture utilizing staff development, technology, and innovative leadership and management strategies.
- Goal VIII – Manage the risk and volatility of assets and liabilities to ensure sufficient funds are available, first to pay benefits and second, to minimize and stabilize contributions.
- Goal IX – Achieve long-term sustainable, risk-adjusted returns.

VII. RESULTS/COSTS:

The cost of the Investment Classification and Organization study conducted by KPMG Management Consulting is \$157,965.

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